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Nos. 211, 212

In the Supreme Court of the United States

OCTOBER TERM, 1950

NIAGARA HUDSON POWER CORPORATION, *Petitioner*

v.

M. VICTOR LEVENTRITT

SECURITIES AND EXCHANGE COMMISSION, *Petitioner*

v.

M. VICTOR LEVENTRITT

On Writs of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF FOR SECURITIES AND EXCHANGE COMMISSION

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BRIEF FOR SECURITIES AND EXCHANGE COMMISSION

OPINIONS BELOW

The opinion of the Court of Appeals (R. 122-126, 128) is reported in 179 F. 2d 615. The opinion of the district court (R. 107-112) is reported in 86 F. Supp. 697. The findings and opinion of the Com-

mission, dated August 16, 1949, and its order dated August 25, 1949, have not yet been officially reported but are set forth in the Commission's Holding Company Act Release Nos. 9270, 9295 (R. 48-95, 103-104).

JURISDICTION

The judgment of the Court of Appeals was entered on February 1, 1950 (R. 128), and was amended by order of February 14, 1950 (R. 128-129). Petitions for rehearing were denied by the Court of Appeals on February 23, 1950, one judge dissenting (R. 151). Petitions for writs of certiorari were granted on October 9, 1950. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254, made applicable by Section 25 of the Public Utility Holding Company Act of 1935, 49 Stat. 835 (15 U. S. C. § 79y).

STATUTE INVOLVED

Sections 11(b) and 11(e) of the Public Utility Holding Company Act of 1935, 49 Stat. 820, 822 (15 U. S. C. §§ 79k(b), 79k(e)), provides in pertinent part as follows:

> (b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:
>
> * * * *
>
> (2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary

company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. . . .

* * * * * * * * * * *

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the com-

pany, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. . . .

QUESTION PRESENTED

Where warrants represent no interest other than an option to buy stock of a holding company at a price, found by the Commission on ample evidence to be substantially in excess of the present value of the stock, or of any future value that might rationally be forecast, does the "fair and equitable" standard of Section 11(e) of the Holding Company Act require, as a matter of law, that the holders of such warrants participate in the assets of the company in reorganization, merely because, in the absence of reorganization, such warrants might have continued to sell in the market at some value in excess of zero?

STATEMENT

This case involves one of two plans filed under Section 11(e) of the Public Utility Holding Company Act of 1935 by Niagara Hudson Power Corporation, a registered holding company. This plan contemplates dissolution of Niagara Hudson and the distribution of its assets among its stockholders after provision for the discharge of its indebtedness. One of the issues before the Commission and the district court, and the principal question dealt with by the Court of Appeals, was whether, under

the "fair and equitable" standard of Section 11(e), any participation should be accorded to the class B stock option warrants of Niagara Hudson. Aspects of the dissolution not concerned with the warrants are not now in controversy.

When the Section 11(e) proceedings were instituted, Niagara Hudson had outstanding the following securities: (1) notes payable to banks in the amount of $20,000,000; (2) first and second preferred stocks, $100 par value, in the amount of 378,875 and 105,930 shares respectively; (3) 9,580,988½ shares of common stock, $1 par value; (4) class B stock option warrants. These warrants represent options to purchase at any time 497,191-3/6 shares of common stock, each warrant entitling the holder thereof to subscribe to 1-1/6 shares of common stock upon payment of $50, or at the rate of $42.86 per share (R. 52).

Both plans were filed by Niagara Hudson under Section 11(e) for the purpose of complying with the provisions of Section 11(b)(2), 48 Stat. 821 (15 U. S. C. 79k(b)(2)), and the Commission's order thereunder (R. 54, 58-59).[1] One of the plans, since consummated and not challenged on appeal to the court below, provided for the consolidation into one operating company of Niagara Hudson's three principal operating subsidiaries, all of whose

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[1] *Niagara Hudson Power Corporation*, Holding Company Act Release No. 5155 (1944); *Niagara Hudson Power Corporation*, Holding Company Act Release Nos. 6083, 6108 (1945), affirmed, *Phillips* v. *SEC*, 156 F. 2d 606 (C. A. 2).

common stocks were owned by Niagara Hudson. This new operating company has issued all of its common stock to Niagara Hudson, while preferred stock was issued to the preferred stockholders of the constituent companies on a share for share basis and bearing the same dividend rates. The second plan, operative only upon consummation of the first, provided for the disposition by Niagara Hudson of its common stock interest in the new operating company by exchanging the same for its own preferred and common stocks, the transfer of Niagara Hudson's relatively small and miscellaneous assets to the new operating company, and the subsequent dissolution of Niagara Hudson.[2] The common stock of the new operating company is allocated to the common stockholders of Niagara Hudson on the basis of 0.78 shares of common stock for one share of Niagara Hudson common stock after payment of the bank loans (R. 54-56, 99-100).[3] No provision was included for participa-

[2] In order to effectuate the foregoing exchange, the common stock of the new operating company, issued to Niagara Hudson for its interest in the constituent companies, was reclassified pursuant to the plan into 1,939,220 shares of class A stock and 7,473,172 shares of common stock. The class A stock, having the same voting rights as the common stock but preferred as to dividends of $1.20 per share and other rights, has been used for the purpose of retiring Niagara Hudson's preferred stocks.

[3] Under the terms of the bank loan agreement, payment of dividends on the common stock of Niagara Hudson was prohibited so long as any part of the loans was outstanding.

tion by the holders of the class B stock option warrants (R. 54-56).

The Commission approved the plan by order dated August 25, 1949 (R. 103-104). On application of the Commission, and after hearing as prescribed in Section 11(e), the United States District Court for the Northern District of New York approved and enforced the plan by order dated November 4, 1949 (R. 1-104, 113-119). Respondent, as owner of 8,000 of the class B stock option warrants, appealed to the court below, complaining of the failure to make any provision for the warrant holders. The court below reversed the order of the district court and remanded the case on the ground that the Commission and the district court had erred in holding that it was "fair and equi-

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Hence, the plan provided that the common stockholders of Niagara Hudson, who wished to exchange their stock for the common stock of the new operating company prior to the retirement of the bank loans and to receive dividends thereon immediately, could do so by paying in cash their proportionate share of the bank loans. Otherwise Niagara Hudson was to retain the common stock of the new operating company and use the dividends thereon for the purpose of retiring these loans (R. 56, 101).

The balance of the bank loans was paid on November 1, 1950. The common stock of the new operating company will be distributed to the common stockholders of Niagara Hudson pursuant to the plan. The remaining assets of Niagara Hudson will be transferred to the new operating company, Niagara Mohawk Power Corporation, which will assume all remaining liabilities, including any obligation of Niagara Hudson with respect to the warrants, if such obligation should be established.

table" to deny the warrant holders a participation in the assets of Niagara Hudson.

The court below affirmed the holdings of the Commission and of the district court that the interests of the warrant holders need not be perpetuated through new option warrants, stating that "in the discharge of [its] duty the Commission was free to eliminate such securities as these, constituting as they did a perpetual right to demand an increase in the common shares of the new company," and that the possibility of such "increase in the capital of a public utility company might well be deemed, certainly a needless, and perhaps a disturbing, 'complexity' in its 'structure' " (R. 123). *Cf. Ecker* v. *Western Pac. R. Co.*, 318 U. S. 448, 475-476.[4] As the court indicated, "the only issue is whether it was permissible to appraise the 'warrants' as worthless" (R. 123). On that issue, the court below accepted the Commission's earnings forecast, and agreed that such forecast indicated a value for the common stock of Niagara Hudson equal to about one-third of the exercise price of the warrants. But for reasons discussed below, it concluded that the present record did not contain "any evidence 'substantial' or insubstantial to support the finding that these 'warrants' were wholly worthless" (R. 126); and that the market history,

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[4] See also Hoagland, *Corporation Finance* (1947) 289-290; Donaldson, *Business Organization and Procedure* (1938) 271; Garner and Forsythe, *Stock Purchase Warrants and "Rights"*, 4 So. Cal. L. Rev. 269, 272 (1931).

including the fact that the warrants sold at more than nominal prices on past occasions when the stock of Niagara Hudson was quoted at about its current value, showed that the warrants had, as of the date of the plan, some positive value (R. 122-125). Judge Clark concurred in the result. He indicated that while there was persuasive evidence in the record to support the Commission's findings, he was disposed in favor of a remand so that the Commission might consider "the market quotations, now deemed so important" (R. 126-127).

On February 15, 1950, the Commission filed a petition for rehearing, in which petition Niagara Hudson joined. In this petition the Commission, *inter alia,* urged that, in the face of the undisputed earnings forecast, market quotations could not be regarded as a proper guide for determining the investment value of the warrants and, further, that in disallowing any participation for the warrants the Commission was fully aware, as the record shows, of the market history of the warrants. (R. 130-150). On February 23, 1950, the court below denied the petitions for rehearing. Judge Clark, who had previously concurred, dissented and voted to grant rehearing (R. 151).

SUMMARY OF ARGUMENT

It is now settled law that the Commission's duty in passing upon the fairness of a plan is to accord each security holder no more nor less than the "investment or going-concern value of his security."

SEC v. *Central-Illinois Securities Corp.*, 338 U. S. 96, 139. To the Commission this means that determinations of value must rest upon rational analysis, rather than conjecture, as to the possibilities of each class of securities participating in the assets and earnings of the enterprise.

Under his contract the warrant holder could acquire the rights of a stockholder and become entitled as such to share in assets or earnings only by paying the exercise price. Accordingly, the Commission valued the warrants by appraising the possibility of the stock becoming worth the exercise price. The Commission's best judgment as to future earnings indicated a value for the stock equal to about one-third the exercise price of the warrants. It was unable to foresee any substantial prospect that the earnings would rise to a point which would make the warrants worth exercising and on this basis it was forced to conclude that the warrants had no intrinsic or investment value. The opinion below appears to agree that there is ample evidence to support the Commission's forecast of foreseeable earnings, and does not intimate that the Commission was compelled to find that there was a substantial prospect of the warrants ever being worth exercising. Under the principles which have heretofore been applied in Holding Company Act reorganizations the Commission was therefore clearly justified in concluding that no "investment or going-concern" value could be at-

tributed to the warrants, and in denying them any participation. The Court of Appeals for the Third Circuit, upon a similar record, upheld the Commission's denial of participation to the holders of Commonwealth & Southern warrants, in square conflict with the decision below. See *In re Commonwealth & Southern Corp.*, 184 F. 2d 81.

The opinion below apparently rejects as irrelevant criteria derived from an appraisal of the intrinsic, or potential exercise, value of the warrants. The court reasoned, first that the warrants have a value as a result of the willingness of purchasers to pay for the chance that current judgment as to the future of the property may be too unfavorable even though this "may be no more than a gamble," and second, that the warrants represent types of interest which under *Otis & Co.* v. *SEC*, 323 U. S. 624, must be compensated. Its decision either requires the Commission to compensate the warrant holders for loss of a potential market value as such or requires the Commission to substitute for its own judgment, derived from analysis of foreseeable earnings, some "average" or other statistical expression of the valuation put upon the warrants by those who traded in them. On either interpretation it represents an unsound departure from the principles which this Court has heretofore upheld. The decision below rests, we believe, upon a misreading of the *Otis* case, in-

terpreted as requiring compensation to a common stock for some remote possibility of value "although the estimate of 'foreseeable' earnings did not justify a conclusion that they would ever leave a margin over the preferred dividends." Actually, the action of the Commission, which the *Otis* case upheld, rested upon a forecast of foreseeable earnings high enough to discharge arrears in preferred dividends in a period of 15 years, whereupon the common stock would be entitled to a liberal share in earnings. The basic controversy was whether the preferred stock was to be valued as a matured claim, or, as was decided, upon a going concern basis.

Since the *Otis* case, as interpreted in the *Central-Illinois* case, is an application of the rule of strict priority, incompatible with the recognition of "amorphous" principles of "colloquial equity," it requires that participations in reorganization rest upon something less elusive than the loss of a remote possibility of participating in the enterprise, or the termination of an opportunity to make a profit by trading in otherwise worthless pieces of paper.

II.

The evidence of market history upon which the court below relied, was relatively weak evidence of intrinsic value. The Commission was fully war-

ranted in rejecting this evidence in view of the mass of evidence in the record from which it derived its forecast of future earnings and its inference that there was no reasonable-prospect of the warrants ever being worth exercising. Even liberal allowances for uncertainties of the future, in recognition of the perpetual call feature of the warrants, did not, in the Commission's view, permit an affirmative finding that the warrants had a value in excess of zero. The fact that the Niagara Hudson stock represented an interest in a regulated industry emphasizes the remoteness of any possibility of future earnings exceeding the Commission's forecast by a margin sufficiently wide to make the warrants worth exercising.

Under the Act, the Commission had the duty of determining the weight to be given the valuation evidence. See *SEC* v. *Central-Illinois Securities Corp.*, 338 U. S. 96, 126. Thus, if the decision below rests upon a ruling that the market history of the warrants was persuasive, rather than exclusive, evidence of their value, it is nonetheless erroneous.

ARGUMENT

I.

The Undisputed Facts Show That on the Basis of Reasonably Anticipated Earnings the Class B Option Warrants Were Without Value.

1. The Niagara Hudson warrants, representing an option without limit of time to purchase its common stock, are a type of securtiy which developed

during the speculative era of the late twenties. Among the more important issuers of these warrants were public utility holding companies and investment trusts. To the conservative investor, who frequently obtained these warrants in connection with the purchase of bonds or preferred stocks, the warrant offered a possibility of additional gain with little or no risk to himself, while, to those with an eye upon the market rather than long term investments, the warrant provided superb opportunities for speculation in the warrants themselves.[5] Such perpetual warrants have seldom, if ever, been exercised, and trading in the warrants has been carried on largely in expectation of profit based on anticipated market trends in the price for the warrants.[6]

Since the warrants in terms provide that the holder thereof should have "no rights as a stockholder" unless he exercised his option, the Commission treated them as entitled to participate only to the extent that they represented a potential interest measured by their exercise price in relation to the potential value of the stock. Under the Act

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[5] I Dewing, *The Financial Policy of Corporations* (1941) 253-254, 255-256, 258-259; Hoagland, *op. cit. supra*, 277, 280-281; Graham and Dodd, *Security Analysis* (1940), 640-641.

[6] See I Dewing, *op. cit. supra*, 254; note u; Guthmann and Dougall, *Corporate Financial Policy* (1948), 344-345.

Because of their speculative character, some doubt has been cast upon the legality of option warrants in general. Berle and Means, *The Modern Corporation and Private Property* (1937), 180-185.

the Commission has the "duty in passing upon the fairness and equity of the plan to accord each security holder, in the order of his priority, the investment or going-concern value of his security." See *SEC* v. *Central-Illinois Securities Corp.*, 338 U. S. 96, 139. This necessarily involved an analysis of prospective earning power applicable to the outstanding securities of Niagara Hudson, both to ascertain whether each class of securities represented any real "going-concern value," and, with respect to those classes of securities found to have a value, to determine whether the securities allocated to them were the equitable equivalent of the interest surrendered. Thus appraisal of future earning power was crucial not only with respect to the treatment of the warrants but with respect to other major issues dealt with in the Commission's opinion.

The Commission's Findings and Opinion contain a comprehensive analysis of both past and prospective earnings of the Niagara Hudson system (R. 62-71, 81-82). Respondent neither participated in developing the administrative record nor brought that record to the court below but limited himself to arguments based upon the facts set forth in the Commission's findings. The Commission's subsidiary findings of fact thus are not, and cannot be, in dispute. The court below did not question the adequacy of the valuation data in the record to support the Commission's forecast of future earnings.

The Commission found, and the court below accepted this finding (R. 124), that were Niagara Hudson to continue as a going enterprise, the system's consolidated net income reasonably might be expected to average about $15,750,000 per year. After deducting dividend requirements of $2,424,000 on Niagara Hudson's preferred stock, this would leave a net income of $13,326,000 applicable to the common stock of Niagara Hudson, or $1.39 per share on the 9,580,988 shares of Niagara Hudson's common stock. On a liberal estimate of a value for the common stock of Niagara Hudson at 15 times consolidated earnings, it would require earnings of $2.86 per share to make the value of this stock approximate the exercise price of $42.86 per share, payment of which the warrant holder was required to make before he would become a stockholder entitled, as such, to participate in the earnings or the assets of the enterprise. The Commission concluded that any possibility of such increment in foreseeable earnings was too remote and speculative and that it could not "find that there is a reasonable expectation that the market price of Niagara Hudson's common stock would exceed the exercise price of the option warrants within the foreseeable future." Accordingly, it concluded the warrants had no measurable and recognizable investment value (R. 82). The warrant holders, therefore, were allowed no participation in the reorganization (R. 82). The district court upheld

the Commission's findings (R. 112, 116; 86 F. Supp. 697, 701).

2. The action of the Commission and of the district court involved nothing more than an application of the rule of strict priority which this Court has repeatedly held to be basic to the term "fair and equitable" as words of art in the historical development of federal reorganization law.[7] In applying that standard this Court has repeatedly emphasized that there must be equivalence between what is given and what is surrendered, and that reasonably prospective earnings constitute the primary criterion of value to be employed in reorganization.[8] This criterion, developed in bankruptcy reorganization is applicable likewise in Section 11(e) reorganizations in determining the present investment value of any class of securities with respect to which the right to participate in the proposed reorganization is asserted.[9] If on

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[7] *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 115.

[8] *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 525-526; *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U. S. 523, 540-542; *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 483.

[9] *Otis & Co.* v. *SEC*, 323 U. S. 624, 631-632; *In re Electric Power & Light Corp.*, 176 F. 2d 687 (C. A. 2); *Lahti* v. *New England Power Association*, 160 F. 2d 845 (C. A. 1); *In re Community Gas & Power Co.*, 168 F. 2d 740 (C. A. 3), certiorari denied, 334 U. S. 846; *In re Jacksonville Gas Co.*, 46 F. Supp. 852 (S. D. Fla.).

the basis of reasonably foreseeable earnings there appears to be no value for a class of securities, such securities cannot be accorded any participation in the reorganized company. These are the elementary requirements of the "fair and equitable" standard and the rule of strict priority applicable alike in bankruptcy reorganization and in reorganization under Section 11(e).[10] It is immaterial whether the interest asserted represents debt, preferred or common stock, or option warrants.

Reorganization or liquidation of solvent holding companies pursuant to the requirements of Section 11(b) of the Holding Company Act, does present one variation from the typical Bankruptcy Act reorganization in that otherwise inchoate rights such as the liquidation preferences of preferred stockholders are "evaluated on the basis of a going business and not as though a liquidation were taking place." *Otis & Co.* v. *SEC*, 323 U. S. 624, 633. See also *SEC* v. *Central-Illinois Securities Corp.*, 338 U. S. 96, 130. We agree with the respondent and the court below that similar principles apply in determining the rights of the Niagara Hudson warrant holders to participate in the instant dissolution. Accordingly, although a warrant represents nothing more than an unexercised option with no present interest in earnings, the Commission would have accorded the warrant hold-

[10] See *Otis & Co.* v. *SEC*, 323 U. S. 624; *SEC* v. *Central-Illinois Securities Corp.*, 338 U. S. 96, 130.

ers a share in the assets at the expense of the common stockholders, if it had found that the liquidation of the company resulted in the transfer of some measurable value from the warrant holders to the stockholders. In fact, the Commission has approved such participation where there was a reasonable expectation of the value of the security exceeding the exercise price of the warrants in the foreseeable future.[11] However, after full consideration of the elaborate valuation data before it, the Commission concluded that there was no reasonable prospect or "expectancy" of the Niagara Hudson common stock ever reaching a value which would make it advantageous for the warrant holders to exercise their option (R. 82). Indeed all the foreseeable factors, including the fact that Niagara Hudson's income was derived from a regulated industry, pointed to the improbability of such extreme appreciation in value. The court below assumed a value for the Niagara Hudson stock of approximately one-third the exercise price of the warrants (R. 124). It did not intimate that the record would support, much less require, a finding that there was any substantial prospect of the stock reaching a value which would make the option worth exercising. Under these circumstances, we believe that the value of the warrants, if any, is

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[11] *Electric Power and Light Corp.*, Holding Company Act Release No. 8889 (1949), pp. 70-74, affirmed, 176 F. 2d 687, 691 (C. A. 2); *Community Gas and Power Co.*, Holding Company Act Release No. 6436 (1946), pp. 29-30.

not susceptible of measurment on any rational basis and cannot support any participation for the warrants.[12]

To compensate the warrant holders at the expense of the stockholders because of nothing more than the impossibility of proving that a rational forecast is infallible, or because unanticipated contingencies may propel earnings to a level not now envisaged, is just as much an invasion of the rule of strict priority as to countenance participation because a security has a nuisance value, *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 115-119; or to recognize the type of "colloquial equity" which this Court has unqualifiedly rejected. See *SEC* v. *Central-Illinois Securities Corp.*, 338 U. S. 96, 152, where this Court stated, "Congress, perhaps believing that the application of such an amorphous standard as that of 'colloquial equity' was beyond the competence of courts and commissions, has instead prescribed the re-

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[12] See, for example, *In re United Gas Corp.*, 58 F. Supp. 501, 519 (D. Del.); In *American & Foreign Power Co.*, Holding Company Act Release No. 7815, 7849 (1947), enforced and affirmed, 80 F. Supp. 514 (D. Me.), warrant holders were denied participation. This plan was subsequently withdrawn because changed circumstances had made the plan unfeasible. In *American States Utilities Corp.*, Holding Company Act Release No. 6540, p. 11 (1946) plan enforced without opinion, D. Neb., No. 96047 (1947), warrant holders, having right to purchase common stock at $20 per share, were denied participation where future earnings applicable to common stock were 53 cents per share.

quirement that investment values be preserved." To the extent that economic developments have indicated that the warrant holders' claim upon the future of the enterprise is a mere will-o'-the-wisp, they cannot equitably exact compensation from the common stockholders for the termination of such claim. As this Court stated in *Schwabacher* v. *United States*, 334 U. S. 182, 199, in connection with the charter rights of security holders of a company subject to Federal reorganization, "Such charters and laws usually have been drawn on assumptions that time and experience have unsettled. Public regulation is not obliged and we cannot lightly assume it is intended to restore values, even if promised by charter terms, if they have already been lost through the operation of economic forces."

3. The decision below cannot be sustained on the peculiar characteristics of option warrants as distinguished from conventional securities. If compensation were required in this case, it would also have to be accorded to apparently worthless stocks, which continue to have a market value as long as they remain outstanding because of their perpetual right to share in future earnings which no one can reasonably foresee.

Under the terms of his contract, the warrant holder has no right or interest in the present assets and earnings of the company; all that he has is a bare right to insist upon delivery of common

stock of Niagara Hudson upon tender of the subscription price, so long as the company remains in existence. The company is not required to maintain its corporate existence for the benefit of the warrant holder; and, if at the time of dissolution the warrant has not been exercised, and is not worth exercising because the value of what he will receive is less than the subscription price, the warrant holder has no cause to complain if his warrant is terminated as an incident to the dissolution.[13] However, as noted above, the Commission has interpreted the *Otis* decision as requiring that the warrant holder's interest be measured on a going concern basis, and not as if in liquidation, thereby going beyond the letter of the contract to treat a mere unexercised option as if it were a present interest in the enterprise. Valuing the *Electric* warrants on that basis, the Commission noted in that case, that "their value lies essentially in the circumstance that they represent a perpetual call upon a portion of the increment in value of the enterprise." *Electric Power and Light Corp.*, Holding Company Act

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[13] Under the terms of his contract, the warrant holder "is entitled to purchase at any time (without limit)" common stock of Niagara Hudson at the rate of $42.86 per share, and "to receive a certificate for the shares of Common Stock so purchased upon presentation and surrender of this Class B Option Warrant duly endorsed and upon payment of the purchase price * * *. This Class B Option Warrant does not entitle the holder hereof to any rights whatsoever as a stockholder of the Corporation." (R. 143, 145).

Release No. 8889, p. 73 (1949).[14] By the same token, participation by the warrant holders necessarily requires a determination whether this possible enchancement in the value of the enterprise, upon which their claim is based, represents something of measurable value, or whether, as the Third Circuit indicated, it is premised on "sheer conjecture" so that it cannot be ascertained with any rational degree of certainty. See *In re Commonwealth & Southern Corp.*, 184 F. 2d 81, 85, discussed pp. 25-26, *infra*. Thus, from the very definition of the warrant holder's interest in the enterprise, it follows that, as in the case of common stock itself, the determination of its value must be made in terms of projected earnings. And, where, on the basis of the evidence it is apparent that such earnings are not likely to reach the potential level at which the warrant holder's interest may be said to commence—in this case when earnings exceed or reach a capitalized value of $42.86 per share—no windfall results to the common stockholders from denying recognition to the warrants.

Except for contrary implications in the decision below, it is settled law that even common stock, whose anticipations are as perpetual as those of option warrants, may not participate in reorganization unless there is some affirmative basis for attributing value to it on a rational hypothesis as

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[14] See also Graham and Dodd, *Security Analysis* (1940) 640, 645.

to future earnings.[15] Warrant holders cannot be expected to be treated with greater solicitude simply because the speculative possibilities of the perpetual warrant are more readily recognized and may have prompted their creation. On the contrary, the extensive reorganizations required by Section 11(b) (2) of the Act reflect, *inter alia*, the legislative findings in Section 1 (b) (1) of the Act, 49 Stat. 803 (15 U. S. C. § 79a(b) (1)), that holding-company securities have been "issued upon the basis of fictitious or unsound asset values hav-

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[15] This has been the uniform tenor of decisions under the Holding Company Act as well as the rule in bankruptcy reorganization. *In re Standard Gas and Electric Co.*, 59 F. Supp. 274, 283, (D. Del.), reversed on other grounds, 151 F. 2d 326 (C. A. 3), certiorari denied, 327 U. S. 796 (common stock); *In re Central States Power and Light Corp.*, 74 F. Supp. 360, 361 (D. Del.); (preferred and common stocks); *In re Jacksonville Gas Co.*, 46 F. Supp. 852, 857 (S. D. Fla.) (common stock). *Cf. Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U. S. 523, 536-542.

Other cases under Section 11(e) of the Act in which common stockholders have been denied participation because they had no measurable investment value in terms of the reasonably prospective earnings are: *Indiana Service Corp.*, Holding Company Act Release Nos. 7054, 7086 (1946), 66 P. U. R. (N. S.), 453, enforced without opinion (N. D. Ind.), appeal dismissed without opinion *sub nom. Propp* v. *SEC* (C. A. 7); *Interstate Power Co.*, Holding Company Act Release Nos. 7143, 7159 (1947), 70 P. U. R. (N. S.) 193, plan enforced, 71 F. Supp. 164 (D. Del.); *Spokane Gas & Fuel Co.*, Holding Company Act Release No. 6065 (1945), enforced without opinion (E. D. Wash.); *Seattle Gas Co.*, Holding Company Act Release No. 7128 (1947), plan enforced without opinion (W. D. Wash.).

ing no fair relation to the sums invested in or the earning capacity of the properties . . . in anticipation of excessive revenues from subsidiary public-utility companies." Hence, where the claim of any security, including warrants, to participate in a reorganization, is unrelated to the "earning capacity of the properties" and is derived from speculative possibilities of "excessive revenues" not justified by reasonably anticipated earnings, the "fair and equitable" requirements of Section 11(e) preclude recognition of these spurious rights or interests. Such putative values "reflect merely vague hopes or possibilities", and junior interests cannot be permitted "to perpetuate their position in an enterprise on such ephemeral grounds." *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 123. Precisely the same considerations apply where the warrant holder is claiming the equivalent in cash of the warrant he is required to surrender. See *SEC* v. *Central-Illinois Securities Corp.*, 338 U. S. 96, 143.

The Commission's approach to the question presented herein was recently affirmed by the Third Circuit in *In re Commonwealth & Southern Corporation*, 184 F. 2d 81. The *Commonwealth & Southern* case, like the instant case, involved a reorganization of a holding company pursuant to Section 11(e) of the Act, in which one of the issues was the treatment to be accorded to warrants giving the holder thereof an option without limit of time to purchase common stock of the company at

$30 a share. The plan excluded the warrant holders from participation, and the Commission found that this was "fair and equitable" on the ground that, on the basis of anticipated earnings, it appeared highly improbable that the value of the common stock would approximate the exercise price. The district court enforced the plan, stating with respect to the warrants, that the Commission's "findings are sustained by adequate evidence." *In re Commonwealth & Southern Corp.*, 84 F. Supp. 809, 811 (D. Del.). On appeal, a warrant holder, represented by counsel who is the respondent herein, challenged the Commission's findings and the Third Circuit affirmed. The court held that the Commission's findings that the option warrants had no recognizable value was "solidly supported by the record." The court agreed with the Commission that reasonably prospective earnings constitute the appropriate criterion for determining the value of a security for which participation in the reorganization is claimed and that such earnings did not justify a finding of positive value for the warrants. In such circumstances, as the court noted, recognition of the warrants would require the Commission "to assume the role of soothsayer and venture a prediction as to a valuation for the options based upon some visionary conception of what the future could bring," and any finding of positive value would be "sheer conjecture based on an arbitrary

assumption which would be quite contrary to the rationale of the Otis and Engineers cases," 184 F. 2d at 84, 85.

4. Rejection of this approach by the court below marks, we believe, a radical departure from the fair and equitable standard. In holding that the elaborate valuation data in the record relating to the value of the stock constituted no evidence at all that the warrants were without value, the majority opinion thereby ignores what Judge Clark characterizes as "the strong case the Commission builds to show that, except for a gambler's chance in the market, the warrants will never produce results . . ." (R. 126). Instead it requires that the warrant holders should be compensated for the loss of an opportunity to continue trading in the warrants and the consequent possibility of selling them for something in excess of zero. We are unable to perceive, however, what considerations of fairness and equity could require that the warrant holder be compensated at the expense of the stockholders for the mere loss of a chance to sell the warrant to some third party for an amount in excess of its intrinsic value.

To the court below value for the warrants results from "a willingness to pay cash for the chance that the market's judgment as to the future of the property may be too unfavorable;" and, although recognizing that such willingness to buy warrants "may, or may not, be the result of a rational fore-

cast" and that it "may be no more than a gamble," the court below concluded that the Congress did not intend to deny them recognition in Holding Company Act reorganizations. In requiring that the Niagara Hudson warrants be accorded such recognition, at the expense of its common stockholders, the court below states that the *Otis* case, 323 U. S. 624,

> . . . appears to us to have recognized property whose value was quite as speculative as this. In that case the common shares of a company in reorganization had no "equity" over the preferred shares at the existing values of the assets, yet the Commission allowed them something out of the pockets of the preferred; and the court affirmed its ruling. That necessarily involved holding that, although the estimate of "foreseeable" earnings did not justify a conclusion that they would ever leave a margin over the preferred dividends, the chance that there might be a margin was not to be denied the common stock which had contributed to the original venture. [R. 125]

We believe this interpretation of the *Otis* case to be erroneous. In that case, this Court sustained the action of the Commission in granting a participation of approximately 5% in the assets of a holding company to common stockholders who had no

present right to earnings because of large preferred dividend arrearages. Such participation was upheld because, upon the Commission's estimate of earnings, it appeared that, in the absence of reorganization, arrearages on preferred stock would be paid off within the foreseeable future and that the common stock would then acquire a right to a share in the earnings of the enterprise. The earnings forecast made by the Commission, while liberal, coincided with the average system earnings for the prior six years, after controversial adjustments for certain items regarded as non-recurrent, and the earnings for the last 12-month period then available, without any such adjustment, actually exceeded the Commission's forecast. See *United Light & Power Co.*, Holding Company Act Release No. 4215, at p. 17. Thus, the forecast, although disputable, was not a wholly arbitrary one. The major controversy upon which both this Court and the Commission divided was whether the preferred stockholders' liquidation preference, including arrears, should be valued on the basis of its going concern value rather than as a matured claim. Once this issue was resolved against maturing the claim of the preferred, it was evident from the earnings forecast that the common stockholders had a real interest in the going concern, although of course there was a risk factor which the Commission took into account in determining whether

approximately 5% of the company's assets was the equitable equivalent of the interest surrendered.[16]

Here, however, the Commission has concluded, as a matter of fact, that the Niagara Hudson warrant holders did not have any measurable interest in the going concern, and, unlike the situation in the *Otis* case, the range of anticipated earnings was far below the level of the potential equity at which the warrant holders claim would assume a legitimate interest in the earnings and assets of the company. As we have indicated, while the legislative history reviewed in the *Otis* case indicates an intention on the part of the Congress that in the administration of Section 11 the Commission should recognize all legitimate investment values, there was no intention of requiring recognition of wholly irrational or conjectural values, which appear beyond the range of probabilities and are based upon nothing more than the speculators' ap-

[16] In the absence of reorganization the common stockholders in that case were entitled to have all earnings applied to build-up their residual equity in the company, either by application to the discharge of the arrears on preferred dividends, which were a non-interest-bearing claim, or through investment in earning assets. By contrast, the Niagara Hudson warrant holders have no contract right to benefit from the company's earnings prior to the exercise of their warrants. While the contract protects them against dilution in value through stock split-ups, it expressly provides, *inter alia*, that the company would be free to pay stock dividends (to the extent of available surplus, we assume) without the necessity for any adjustment in the warrant exercise price (R. 144).

praisal of remote contingencies. *See Otis & Co.* v. *SEC*, 323 U. S. 624, 636.

The vigorous dissent in the *Otis* case by one of the Commissioners and by three Justices of this Court appears to reflect an apprehension that the valuation technique there employed might lend itself to an arbitrary disregard of the rights of senior security holders for the benefit of junior interests. Thus, the Commission's valuation was characterized by the dissenting Justices as "peering into the future with almost clairvoyant percipience," 323 U. S. 624, 642. While we do not agree that this is a valid criticism of the Commission's application of the fair and equitable standard, general acceptance of the interpretation of the *Otis* case put on it by the court below would go far to vindicate that expression of dissent.

II.

The Commission Was Not Required to Accord a Participation to the Warrants Merely on the Basis of Their Past Market History, Where Its Undisputed Findings Regarding Prospective Earnings, Plus a Liberal Allowance for Uncertainties, Clearly Indicated Lack of Value.

In the court below, respondent derived a double-barreled argument from the market history of the warrants. He contended, first, that this market history was compelling evidence of value which outweighed the inferences drawn by the Commission from its own analysis of future earning power applicable to Niagara Hudson's common

stock; and second, that since warrants are commonly purchased as a "hedge" against the uncertainties of the future, and thus without reference to any estimate of the probable future value of the security subject to option, they are entitled to compensation for loss of market value as such. We believe the opinion below rests primarily upon an acceptance of the latter argument, already dealt with in Point I of our brief.

1. The Commission was not compelled to accept the market history of the warrants as conclusive evidence of their intrinsic value. As the Court of Appeals for the Third Circuit held with reference to the similar market history in the *Commonwealth & Southern* case, even if it constituted some evidence of value, this evidence had not "eliminated or necessarily rendered less credible" the evidence before the Commission "which it was entitled to accept, that the possibility of future earnings of Commonwealth sufficient to establish value in the warrants was extremely remote" (184 F. 2d 81, 85).

In our view, the market history of the warrants constitutes relatively remote and, certainly inconclusive, evidence of their intrinsic value. This market history is summarized in Appendix F to the Commission's opinion (R. 90). The past market prices, as the Third Circuit observed, to a large extent represented "out and out market gambling," while the more recent price quotations reflected "deliberate speculation as to what the Com-

mission's course would be in connection with the option warrants in question" (184 F. 2d 81, 85). The range of quotations summarized in that table could represent at most the opinions of the divers parties to transactions in the warrants, opinions which showed the widest variation over the years and between each year.[17] We have appended a chart showing the variations in quotations for the warrants expressed as a percentage of quotations for the stocks at the end of each quarter during the years selected by respondent. See Appendix.

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[17] Respondent below argued, on the basis of a deceptively simple chart, that there was a relationship between "the annual mean prices" (the mid point between the high and the low for the years 1932 to 1947) for the Niagara Hudson common stock and warrants which indicated a permanent value for 5½ warrants equal to one share of common stock. On the basis of these figures respondent argued before the Commission that the warrants had a value of $2.00 apiece, and before the Court of Appeals (the market having gone up after the Commission's approval of the plan) for a value of $3.00 a warrant. Respondent's own cost in the course of the proceedings was $1500 for 8,000 warrants, for which he would receive $16,000 at $2.00 apiece or $24,000 at $3.00 apiece or from over 10 to over 15 times his own cost. While the approach of the court below was less mechanical, it apparently was impressed by the fact that "in the six high years, 1933-1939, when the average of the high for the shares was nearly thirteen, and the average of the high for the 'warrants' was two and a half, the proportion was about one to five." (R. 123) We believe that inferences drawn from "averaging" the highest of particular years from median prices gives a wholly illusory picture concerning the degree of persistence in market appraisals of the relationship between warrants and the stock.

We question whether those whose purchases are reflected by the market history of the warrants had an opportunity to make a serious study of the company's future at all comparable to that made by the Commission and by the witnesses who testified in the proceeding. More significantly, we believe that the market history of the warrants, relied upon by respondent and the court below, does not even substantially reflect the opinion of those who dealt in the warrants as to the possibility of the warrants ever becoming worth exercising.[18] If we start, as the court below did start, with the unchallenged finding of the Commission that there is no basis for a rational forecast that the Niagara Hudson common stock would ever reach a value equal to the exercise price, then no purchaser of the warrants, however well-informed as to the possibilities of the company, could be in a position to make more than the blindest guess as to the intrinsic value of the warrants. In that respect transactions in the warrants could represent nothing more

[18] The court below was forced to disregard recent quotations indicating only a nominal value for the warrants (between 1/4 and 1/8 during the first half of 1949). Presumably this was because the court assumed that the recent market reflected an anticipation that the warrants would soon be extinguished and that the warrant holders would probably receive nothing in the plan. We agree that this was a good reason for disregarding the recent market for the warrants, but believe, for reasons stated in the text, that the Commission had equally good reasons for rejecting the market appraisal in earlier years.

than a type of market behavior which reflects the ebb and flow of speculative sentiment in regard to securities which are worthless by any rational criterion.[19] This is the significance, we believe, of the fact which impressed the court below "that at no time did the 'warrants' become worthless, not even when the shares had gone down to their low of seven-eighths" (R. 123-124).

The fact, confirmed by the market history of the Niagara Hudson warrants, that such warrants continue to be traded, no matter how remote the prospect of their acquiring an exercise value, and the further fact that in rising markets quotations for the warrants tend to rise much more rapidly than for the stock, indicate merely that so long as such warrants continue outstanding they afford a convenient mechanism of speculative trading.[20] This fact itself supplies a motivation for the purchase and sale of the warrants wholly unrelated to any possible expectation of exercising the warrants on the part of those who trade in them.

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[19] Recent trading in Russian Imperial bonds which during this year have been fluctuating between $17.50 and $36.25 per thousand dollars provides an illustration of such trading. *New York Times*, November 2, 1950, p. 54.

[20] As the opinion below notes (R. 125), when the market price for the common stock rises the market price for the warrants also rises but at a proportionately higher rate, and those who are actually astute enough or lucky enough to anticipate the ups and downs of the market can obtain greater profits with a given outlay of capital invested in the warrants than from speculating in the stock. See also note 5, *supra*.

2. Respondent argued below that in the *Electric Power and Light* case the Commission itself rested its valuation of option warrants upon a study of past market relationships between the warrants and the common stock on which the warrant holders had an option. The *Electric* case involved a perpetual warrant entitling the holder thereof to purchase common stock of the company at $25 per share. The Commission approved a plan allocating new common stock to the warrant holders at the ratio of one share of stock for three warrants, where, on the basis of future earnings, the value of the common stock "would be between $25 and $30 per share." See Holding Company Act Release No. 8889, pp. 73-74. Thus, the significant difference between the *Electric* case and the instant case is that in the *Electric* case the Commission found from its analysis of earning power that there was "probability of the market price of Electric's common stock exceeding the exercise price of the warrant within the foreseeable future."[21] In the instant case, as we have seen, the Commission was unable to forecast, from its analysis of earning power, a reasonable possibility of the Niagara Hudson warrants reaching the point of parity with the exercise price where it started in the *Electric* case.

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[21] On that ground the Commission specifically distinguished its holding in the *Commonwealth & Southern* case, since affirmed by the Third Circuit. See Holding Company Act Release No. 8889, p. 74, n. 78.

Even in the *Electric* case, moreover, the Commission did not rest its approval of an allocation to the warrant holders upon any historical market relationship between the prices for the stock and the warrants but expressly stated that this was a matter of judgment weighing all the circumstances.[22] The Commission specifically rejected attributing any controlling influence to the market, stating "that the past relationships between the market price of the warrant and the common stock should not be controlling in fixing the relative participations to be accorded as between the common stock and the warrants," in view of its inference that the past market for the warrants reflected in substantial part "the greater speculative possibility provided by like amounts of capital if used to purchase warrants than like amounts of stock."[23] In

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[22] The Commission did summarize in its opinion a study made by one of the witnesses as to certain relationships between the price of the warrants and the stock, from which it appeared that the perpetual call feature of the warrants reached its highest valuation in the market at times when the stock sold immediately below the exercise price. If this opinion can be interpreted as attributing any significance at all to the market history it would appear to be merely by way of confirmation of the Commission's independent judgment that a call on stock, at a price somewhere near its apparent current value, is itself a privilege of substantial value, although necessarily difficult to measure.

[23] The court below which had previously upheld the Commission's decision in the *Electric Power and Light* case referred in the instant case to the above quotation from the Commission opinion in the earlier case and stated: "That may

the instant case, the Commission concluded that the warrants had no foreseeable exercise value, that it regarded any value which the market might have attributed to them in the absence of a plan, as representing exclusively that type of speculative element which it eliminated from consideration in the *Electric* case.[24] We believe the chief significance of the *Electric* case is that the Commission does give full recognition to the "perpetual call" feature of a warrant, and does make a substantial allowance for the possibility that the future value of the stock, upon which the warrant holder has an option, may be worth more than the particular amount which reflects the application of a fair discount rate to the Commission's best estimate of future earnings. In the instant case, however, the application of this technique failed to indicate any affirmative value for the warrants.

3. Respondent argued below that a strong probability of the common stock of Niagara acquiring

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well be true, and the Commission was of course free to use it as a factor in its appraisal of the 'warrants' at bar, although it is indeed a nebulous factor" (R. 125).

[24] Respondent did not urge below that the Commission had failed to consider the market history and indeed his entire argument was built upon the summary of that history contained in the Commission's findings. As the Court of Appeals for the Third Circuit noted in the *Commonwealth & Southern* case, the complaint was merely that the Commission refused to attribute significance to the market value in view of its conclusions drawn from analysis of earning power, 184 F. 2d 81, 85.

a future value equal to or in excess of the exercise price could be inferred from the great percentage increase in the market value of the stock since its low in 1942, urging that with the stock selling as of the time of the argument below at 16, that represented an increase of 18 times from its low of ⅞, and that only about a 200 percent further increase was necessary to bring it to the warrant exercise price of $42.86 a share. Apart from the superficial plausibility of this type of reasoning, we believe its fallacy is readily demonstrable when reference is made to the financial history of Niagara Hudson from 1942 to the date of the plan. In 1942 the common stock of Niagara Hudson shared the disfavor generally applicable to holding company shares. As a "leverage" security it reflected in exaggerated degree the unfavorable impact of the advent of a war economy and higher taxes upon equity securities of public utility companies. Except for a small dividend in 1940, no dividends had been paid on its common stock since 1938 (R. 87). Preferred dividends were suspended in 1942 because of problems incident to the enforced write down of the assets of operating subsidiaries, and the necessity of an accounting reorganization to permit distribution of current earnings. Since that date the difficulties of Niagara, which may well have been given a distorted interpretation by those who sold its common stock at close to nomi-

nal prices, have been largely eliminated. Accounting reorganizations have removed blocks to the distribution of earnings, dividend arrears on the preferred stock have been paid recently, the operating companies have been refinanced on a relatively low cost basis, many corporate entities have been eliminated and the system generally simplified. (R. 53-54, 58-59, 75-76). The present plan provides for receipt by the Niagara Hudson common stockholders, upon dissolution, of common stock of a soundly financed operating company. Obviously, current market prices of Niagara Hudson reflect these substantial improvements. The adoption by the Commission of approximately $1.39 per share as reasonably foreseeable earnings was based upon a consideration of all these facts, including the impact of rate regulation (R. 63-65, 69, 70-71).

The remoteness of the possibility that Niagara's income applicable to its common stock would greatly exceed the Commission's forecast is underlined by the fact that the former leverage characteristics of the Niagara Hudson stock had been greatly reduced and the Commission's forecast of earnings from public utility operations reflect a rate of return equal to, if not exceeding, the maximum which the rate regulatory authority was likely to permit (R. 71). Thus, the Commission's forecast works out as a return of 6.53% upon the indicated rate base (R. 70-73). The Securities and Exchange Commission, while reluctant to an-

ticipate the action of a state regulatory body, was able to point to intimations of the New York Public Service Commission that it believed there was a basis for rate reductions in a "cursory study of the income statements" of the Niagara Hudson's subsidiaries, while recent decisions of that commission in rate cases involving other companies had not permitted rates of return in excess of 6% on the rate base (R. 70).[25] The Commission's refusal to assume, as a basis for according a participation to the warrant holders, a reasonable possibility of future earnings per share exceeding its own forecast by as much as 100% was buttressed by the fact that this would involve a return equal approximately to 10% on the indicated present rate base.

In the light of the foregoing analysis, it does not follow that merely because Niagara Hudson common stock increased by 15⅛ over the 1942 low of ⅞, an increase of over 1700%, it is reasonable to expect an increment of about 200% over the recent price of 16. Even if it were assumed, *arguendo*, that over the years the price of Niagara Hudson common stock would rise by an additional $15, such a change would represent an increase of less than 100% and would be far short of the exercise price of $42.86 per share.

The court below did not accept respondent's invitation to prophesy a future increase of over 200%

[25] *Long Island Lighting Co.*, 18 P. U. R. (N. S.) 65, 212, 213 (1935) (6%); *Staten Island Edison Corp.*, 60 P. U. R. (N. S.) 385, 488 (1945) (5½%); *Orange & Rockland Electric Co.*, 49 P. U. R. (N. S.) 257, 318-319 (1943) (5½%).

in Niagara Hudson's common stock. Nevertheless, there is intimation in the opinion that it did not consider the prospect of such an increase so negligible as to support the denial of any participation at all by the Commission. Thus the opinion states (R. 125-126):

> Besides, it must be remembered that the finding that the "warrants" at bar had no value whatever was just as much of a guess, as a finding that they had some particular value. We are forced to deal in prophecies in any event; and, unless courts are to have no review at all, they cannot avoid acting upon such impalpable ingredients. Clearly there can be appraisals which no "substantial evidence" supports; and one guess is not as good as another, unless all findings of the Commission are to be final.

Whether the market history of the warrants be regarded as strong or weak evidence of their intrinsic value or whether past percentage increases in the value of Niagara Hudson's common stock do or do not support an inference of probable future increase by over 200%, we believe it clear that it was the Commission's function to determine the weight to be accorded such evidence as compared to evidence concerning foreseeable earnings. See *SEC* v. *Central-Illinois Securities Corp.*, 338 U. S. 96, 126. The basis for administrative finality in this area rests not alone upon the

Congressional intention to rely upon a specialized administrative agency, rather than a reviewing court, to make the "guess" as to the future, but in the desire of the Congress for reasonably uniform and expeditious determination of matters not susceptible of exact proof. *Cf. SEC* v. *Central-Illinois Securities Corp.*, 338 U. S. 96, 124.

Apparently, the court below was not prepared to rule that, as a matter of law, the evidence indicated some minimum value for the warrants. Such a ruling, however contrary to our conception of the requirements of the substantial evidence rule, would at least permit a reasonably expeditious resolution of the controversy. But in holding merely that the Commission could not find the warrants worthless, while disclaiming any intention of indicating what their value might be, or of promulgating a standard by which the Commission should determine their value, the opinion below holds forth only the prospect of a long process of repeated trial and error before there can be a concurrence between the administrative and judicial "guess" as to the value of the warrants.

However, the main thrust of the opinion below, does not appear to us to rest upon a substitution of the Court's guess that the warrants had some value, for the Commission's guess that they had no intrinsic value. Instead, it appears that the Court was driven to reliance upon the market history because of its interpretation of the *Otis* case as requiring that warrant holders be compensated at

the expense of common stockholders for deprivation of a mere gambler's chance of participating in an unpredictable future appreciation in value. As we have argued in Point I, *supra*, this is a misinterpretation of the *Otis* case and contravenes the long line of authorities which uphold the rule of strict priority.

CONCLUSION

The judgment of the Court below should be reversed. The order of the District Court, which denies any participation to the class B stock options warrants, should be affirmed.

Respectfully submitted,

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NIAGARA HUDSON POWER CORPORATION

RELATIONSHIP OF MARKET PRICES OF COMMON STOCK AND $3\frac{1}{2}$ WARRANTS
AT CLOSE OF EACH QUARTER YEAR, 1937-1947